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SUBJECT: AMBASSADOR MEETS ECONOMY MINISTER

Ref: Belgrade 882

SUMMARY

1. (SBU) The Ambassador met with new Minister of Economy Mladjan Dinkic for the first time on June 20 to review the economic agenda for the new government. Dinkic, leader of the G17 party, said that he personally favors a partition of Kosovo but said that preserving momentum on Euro-Atlantic relations and ties between Serbia and the U.S. is necessary. He pledged that Russian economic interests would not be awarded special treatment in Serbia, notwithstanding Russian support on Kosovo. Bankruptcy will be used for companies that cannot be sold by other means, and he said that a decision already had been made to move some 200 enterprises into bankruptcy. With regard to relations with the IMF, he was non-committal, saying there is discussion of a precautionary, "but no one is pushing." end summary.

2. The Ambassador met with Minister of Economy Mladjan Dinkic for the first time on June 20. Dinkic leads a ministry that took on much greater responsibilities based on the coalition agreement and the subsequent law on ministries. It obtained foreign trade and export control from the now-eliminated Ministry of International Economic Relations; it took employment from the Ministry of Labor and Social Affairs; it acquired regional development, including supervision of the quasi-bank Fund for Development, and it took tourism from the Ministry of Trade (which now handles only internal trade issues.). Dinkic, whose party captured just over six percent of the vote and 19 deputy seats to become the junior partner in the new Kostunica government, was accompanied by one aide, while econ chief and USAID LES joined the Ambassador.

3. (SBU) The Ambassador opened the discussion by asking Dinkic, as leader of one of the three coalition parties, for his views on likely developments in regard to Kosovo. Serbia is in a tough position, the Ambassador noted, pursuing a hardline stance on Kosovo while seeking Euro-Atlantic integration. We must face the reality that Kosovo will be independent, the Ambassador said, but find a way to pursue our bilateral agenda at the same time.

4. (SBU) The situation is not pleasant, Dinkic said. Since 2001 Serbia's relations with the U.S. have improved steadily, but now a single political issue separates us. His view is that partition would be best, Dinkic said, but neither party to the dispute welcomes this stance. The best course would be for the U.S. to show a bit more flexibility; then it would be in a position to request, and expect, more flexibility from President Tadic and Prime Minister Kostunica. It is not possible to change the view of the Serbian side "100 percent," he warned, but the Kostunica government must try to

solve this issue in some way that permits it to move forward on integration and maintain good relations with all states.

¶15. (SBU) The Ambassador noted that the U.S. agrees wholeheartedly with four of the main goals of the Kostunica platform; only on the fifth, Kosovo, is there disagreement. Serbia should not permit its stance on one issue to defeat progress on the other four. It is unlikely that we will agree on Kosovo, the Ambassador said, but we must move forward nonetheless. Dinkic agreed that this is the only option.

¶16. (SBU) The Ambassador noted that Dinkic is in large measure the architect of Serbia's economic recovery, an area on which we can and do work together. But one issue on the economic side is troubling: the push by Russian companies for economic gains. Dinkic replied that Russian companies would be treated like any others, which includes the requirement for tenders in any privatization. Only in natural gas does Russia have a special position, he said, and that is a function of its monopoly position as supplier.

¶17. (SBU) Dinkic said that Prime Minister Kostunica had asked that Trade Minister Bubalo be the Serbian chair of a joint Serbian-Russian commission on economic relations, although normally the economy minister would chair. He had agreed. Econ chief asked about recent Russian interest in a cargo terminal joint venture at Belgrade airport. Dinkic replied that he had learned of such interest and had discussed it with President Tadic. Both agreed that any such deal must be handled transparently, and it would require a decision by the entire government. The document signed by the airport's board chair had no legal force, he added.

¶18. (SBU) The Ambassador turned to the impending privatization of state-owned oil company Naftna Industrija Srbije. He noted that the economy minister had publicly advocated selling a majority stake, but it is not clear whether that will be the coalition policy. Dinkic replied that the coalition, when formed, had agreed that the minimum would be the Merrill Lynch strategy of immediate sell-off of 25 percent, with management control, to a strategic partner, to be followed by an increase to 37.5 percent equity via additional investment. Dinkic said he did favor immediate sale of majority, but said that Deputy Prime Minister Djelic did not share this view. We would see what would happen, he said, adding that the finance minister should join the debate and make his views clear.

¶19. (SBU) Dinkic said that other deals will move forward. Insurer DDOR Novi Sad should be sold by the end of the year. The next step for state airline JAT is to hire a financial adviser to help in the search for a strategic partner. JAT's maintenance subsidiary would be tendered soon, he added, and it already had attracted interest from other companies. The Ambassador asked whether Aeroflot could be a serious contender for JAT. Dinkic replied that it does appear to be serious about making an offer.

¶10. (SBU) Turning to assistance issues, the Ambassador explained that USAID is cooperating with the Agency for Privatization on bankruptcy for socially-owned companies that had not found a buyer. The economic minister replied that he favored completing privatization via bankruptcy when there is no other option. The Ministry would move to put several companies in bankruptcy soon, including the Matroz paper plant. Auctions of such assets would begin in the autumn, he said. He noted that as central bank governor, he had taken a tough approach in closing many banks, but the strategy had paid off in the end.

¶11. (SBU) The Ambassador brought up one bankruptcy case that had proved troubling. U.S. company Ocean Atlantic had attempted to buy property from a bankruptcy auction, but its bid was turned down by the bankruptcy administrator in what appeared to be an example of corruption. Dinkic said that he already had decided to change the director of the Bankruptcy Supervisory Agency.

¶12. (SBU) Restitution is an issue where we would like to see the new government move expeditiously, the Ambassador said. The Embassy had reviewed the draft approved by the previous government, but restitution claimants who are U.S. citizens had raised several issues. The Embassy had put together a list of suggestions, and he passed a copy to the minister. But it is important to move sooner rather than later, the Ambassador added, to avoid any transformation of restitution into a major political issue. Dinkic replied that the Ministry of Finance would be working on the law, but offered to review Embassy suggestions.

¶13. (SBU) The Ambassador applauded the way in which the previous government had worked with U.S. investor Philip Morris to resolve issues raised by the CEFTA agreement. Such aftercare for established investors is important. The new government could send a positive signal to the investment community by quickly coming to terms with U.S. investor Uniworld, the Ambassador added. An international arbitration tribunal had recently decided for Uniworld in its dispute with the Agency for Privatization over the Putnik travel agency.

¶14. (SBU) Dinkic said that the Government of Serbia had been told by its lawyers that further legal avenues for appeal were available, and it would seek to overturn the arbitration decision. The U.S. would do the same to protect its legal interests, he added. But the minister noted that in the Valeant investment dispute, the Government of Serbia had eventually settled with the claimant. The Ambassador said that a quick settlement would be welcome, but added that he understands GOS determination to exhaust its legal remedies.

¶15. (SBU) Econ chief asked how the Minister regarded the outlook for an IMF agreement. Dinkic replied that such an option was under discussion, but no one in the GOS really is pushing for such a deal. The overall macroeconomic situation is promising, and he added that slow budget execution would offset to some extent the expansionary impact of the 2007 budget proposal.

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